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World Oil Market Outlook: Key Political and Economic Dimensions

National Intelligence Estimate

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13 April 1984*

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WORLD OIL MARKET OUTLOOK:
KEY POLITICAL AND
ECONOMIC DIMENSIONS

Information available as of 13 April 1984 was
used in the preparation of this Estimate.

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THIS ESTIMATE IS ISSUED BY THE DIRECTOR OF CENTRAL INTELLIGENCE.

THE NATIONAL FOREIGN INTELLIGENCE BOARD CONCURS.

The following intelligence organizations participated in the preparation of the Estimate:

The Central Intelligence Agency, the Defense Intelligence Agency, the National Security Agency, and the intelligence organizations of the Departments of State and the Treasury.

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SCOPE NOTE

This Special National Intelligence Estimate examines the outlook for the world oil market through 1986 and the implications of possible major discontinuities. The emphasis is on developments that could produce a pronounced fall or sharp rise in oil prices and the interplay of oil market forces and political and economic pressures.

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KEY JUDGMENTS

Unless the threats to Persian Gulf oil supplies are realized,¹ the underlying pressures on the oil market will be downward over the next three years or so, resulting in a decline of oil prices in real terms, although probably not in nominal terms. Several member nations of the Organization of Petroleum Exporting Countries (OPEC), notably Nigeria, Venezuela, Iraq, and possibly Libya, will see increased oil sales as the principal way to ease their severe economic problems and perhaps to maintain political stability. It will be difficult to reconcile these pressures for higher oil output with the likely slow increase in demand for OPEC oil. Saudi Arabia will remain the swing producer and under some circumstances will have to cut its already low production further to balance the market.

The chances are that OPEC will hold together despite these pressures. The OPEC countries have powerful common interests in avoiding a large price decline and have developed patterns of cooperation. Saudi Arabia, the lowest cost producer with the largest reserves, considers maintenance of the current \$29 price to be consistent with its long-term national interests, although the Saudis might prefer a somewhat lower price—for example, \$25 a barrel—if oil demand proved weaker than expected.

In the unlikely case OPEC cooperation should break down, competition for market shares would quickly push prices down, perhaps to \$15 a barrel or less. But we believe that such a price collapse would, within a few months, cause OPEC producers to regroup and agree again on controlling production, and that the price of oil would be set in the \$25 to \$29 range.

At the other extreme, the intensification of the Iran-Iraq war could disrupt oil supplies, through a temporary closure of the Persian Gulf or damage to Gulf oil facilities, and produce a sharp increase in oil prices. Under the most likely disruptions, however, oil supply reductions would be brief enough to be absorbed through stock drawdowns or too small to reduce world supplies because of the prevalence of excess productive capacity; consequently, prices would quickly return to, or even fall below, their previous level. The inevitable uncertainties during a supply

¹ See SNIE 34/36-2-83, *Iran-Iraq War: Increased Threat to Persian Gulf Oil Exports* (S NF), 13 October 1983.

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interruption would breed speculative buying that would add to any price rise, but it is unlikely that a buildup of oil stocks would play as large a role as it did in 1979.

Large price increases lasting several months would require systematic, continuing Iranian attacks (conventional and unconventional) against tankers or key oil facilities in the Persian Gulf or sufficient damage to Saudi facilities to make the Saudis incapable of holding down the price of oil.

Even if no major oil supply interruptions occur, we cannot rule out the possibility that, should Iranian power become dominant in the Persian Gulf, and Saudi Arabia were also subjected to protracted externally directed subversion, the Saudi Government would no longer have the self-confidence to play a strong leadership role in OPEC. This might mean, for example, not increasing their oil production to prevent other OPEC countries from raising oil prices.

A stable or slowly declining oil price would have generally favorable effects on the world economy because it would tend both to stimulate economic growth and to slow inflation; it would particularly benefit nonoil developing countries with large debt problems by reducing their debt service burden. Several oil exporters, however, would face growing economic difficulties, and perhaps political instability. Nigerian politics may become increasingly chaotic with declining revenues, heightening the prospects for a series of coups and counter-coups that could allow a radical, anti-Western regime to seize power. Venezuela has no alternative sources of revenue to oil exports, and its democratic institutions may have great difficulty coping with several more years of economic stagnation or decline. Libya has far more flexibility than Nigeria or Venezuela but would be unable to finance some of its major domestic and foreign policy goals. Soviet hard currency earnings would be reduced and oil deliveries to Eastern Europe could be cut back, aggravating the already austere economic conditions. These countries in turn might take advantage of the soft oil market to accelerate bartering goods for oil.

A large oil price increase, on the other hand, could do substantial damage to the world economy and it could lead to a moratorium on debt service in Brazil and other key oil-importing LDCs. It would slow Western economic recovery and would be a major benefit for the USSR. Moscow's hard currency earnings would increase by \$2.5 billion, or 7 percent for every \$5 increase in oil prices. The Soviets could also benefit indirectly from the strains that would occur within the West as a result of oil supply disruptions and price hikes.

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DISCUSSION

1. The weak oil market of today grew out of the oil price explosions of the 1970s. Oil consumption in the major industrial nations² fell by 8 million barrels per day (b/d) or roughly 20 percent between 1979, the peak year, and 1983. The drop in consumption was a result of a combination of reduced economic growth, energy conservation, and substitution of other forms of energy for oil. It was sustained by such factors as the shift away from energy-intensive industry to services and the strength of the US dollar (see table 1).

2. Lower consumption resulted in a drastic reduction in industrial countries' oil imports, including imports of oil from the member nations of the Organization of Petroleum Exporting Countries (OPEC). Total US oil imports dropped from a peak of 8.8 million b/d in 1977 to 4.7 million b/d in 1983, those of Japan from 5.5 to 4.3 million b/d, and those of France from 2.5 to 1.8 million b/d during the same time frame.

3. The reduced demand for oil has produced strains within OPEC, although in 1983 OPEC members reached agreement on a cut in official prices and set associated production quotas. Although the Saudis have borne the brunt of demand cuts, producing as much as 4 million b/d below their capacity in the first

quarter and acting as the residual supplier in the market, prices could not have been maintained without substantial cooperation from other OPEC countries. Kuwait, Libya, Nigeria, the UAE, Venezuela, and Iran are producing well below their capacity and the levels at which they would prefer to produce. Iraq's production continues to be held down by the war. Current surplus capacity in non-Communist countries is about 8 million b/d, but only about 3 million b/d of excess capacity is located outside the Persian Gulf. Mexico is the only non-OPEC producer with sizable surplus capacity, about 200,000 b/d.

4. The drop in oil exporter revenues has brought problems—mainly economic, but also political—for oil-exporting states, including those outside of OPEC. All of the oil states boosted spending sharply in the revenue boom years; some also turned to heavy borrowing. In the latter category, Mexico, Venezuela, and Nigeria have had to enter into renegotiations of their enormous debt loads. Financial problems in Nigeria and Venezuela have contributed to changes in government—by a military coup in the case of Nigeria. Table 2 presents oil earnings, imports, and the current account balance for the major OPEC countries in 1978, before the last large oil price increase, and in 1981, the peak year for oil earnings in most OPEC countries, except Iran and Iraq, and 1983. Imports have had to be cut sharply in Iraq, Nigeria, Venezuela,

² Members of the Organization of Economic Cooperation and Development (OECD).

Table 1

OECD Energy Consumption

	1973		1979		1983	
	Million Barrels per Day Oil Equivalent	Percent of Total Energy Consumption	Million Barrels per Day Oil Equivalent	Percent of Total Energy Consumption	Million Barrels per Day Oil Equivalent	Percent of Total Energy Consumption
Oil	39.8	54	40.6	52	33.0	46
Natural gas	14.4	20	15.2	19	13.1	18
Coal	14.0	19	15.2	20	16.0	22
Nuclear power	.9	1	5.1	6	4.0	6
Other	4.5	6	2.7	3	5.8	8
Total	73.6	100	78.8	100	71.9	100

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Table 2

Billion US \$

OPEC Earnings and Imports

	Oil Export Earnings			Merchandise Imports (fob)			Current Account Balance ^a		
	1978	1981	1983 ^b	1978	1981	1983 ^b	1978	1981	1983 ^b
Saudi Arabia	36	110	45	20	34	39	-2	57	-15
Kuwait	9	14	9	4	7	7	5	12	7
United Arab Emirates	8	19	12	5	9	8	2	8	2
Iraq	11	11	8	7	20	11	1	-17	-9
Iran	21	11	20	18	11	15	1	-2	NEGL
Nigeria	9	17	11	12	18	9	-5	-5	-1
Venezuela	9	19	14	11	12	8	-6	2	1
Libya	10	15	11	7	15	8	1	-4	-1
Indonesia	6	15	9	8	17	15	-1	NEGL	-4
Others	10	21	14	12	15	14	-4	1	-1
Total	129	252	153	104	158	134	-8	52	-21

^a In addition to oil exports and merchandise imports, includes non-oil-export earnings, payments on receipts for services, grants, investments income, and transfers such as worker remittances.

^b Estimate.

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and Libya, and in some cases are also below the 1978 level. Moreover, since 1981 official foreign assets in OPEC countries have declined 10 percent to \$293 billion and debt has increased by 20 percent, as shown in table 3.

5. The near-term market outlook is affected by conflicting pressures. On the one hand, the poorer producing states are under pressure to sell more oil to boost oil export revenues, thereby adding to downward price pressures. On the other, the war between Iran and Iraq threatens to expand and interfere with deliveries through the Gulf and drive up price.

Market Trends and Uncertainties

6. Barring a major supply disruption, we believe the market is likely to remain weak for the next several years. On the basis of trends in the world economy and on nonoil energy markets, and assuming a constant nominal oil price, oil consumption in the non-Communist world is expected to grow by only about 1 or 2 percent annually through 1986. With some increase in oil supplies likely from non-OPEC sources, demand for OPEC oil will also grow only slowly. There is, however, a considerable range of uncertainty.

7. Among the major factors affecting oil demand, most forecasters agree on the following:

- OECD economic growth of 2.5 to 3 percent a year through 1986 (with the United States and

Japan leading the way) and LDC growth of about 3 to 4 percent (substantially slower than in the 1970s, but still slightly faster than in industrial nations).

- Continuing energy conservation, but at a declining rate. Many energy-saving investments continue to be profitable, and the impact of earlier conservation decisions—for example, in the design of buildings, machinery, and vehicles—is increasing. On the other hand, where energy prices have fallen substantially, as in the case of gasoline in the United States, there are signs of reduced interest in conservation (see figure 1).
- Continuing substitution of other energy sources for oil, but also at a declining rate. Most profitable substitution possibilities in existing plants apparently have already been completed, but new construction is based increasingly on nonoil energy sources (see figure 2).

8. Non-OPEC oil supplies are likely to increase by up to 1 million b/d in the next three years. Most experts expect US and Canadian production to be marginally down, North Sea production to level off, and Mexican production to continue rising, but only slowly because of a slowdown in investment. Perhaps an additional 0.2-0.3 million b/d will come from other

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Table 3

Billion US \$

OPEC Reserves and Debt

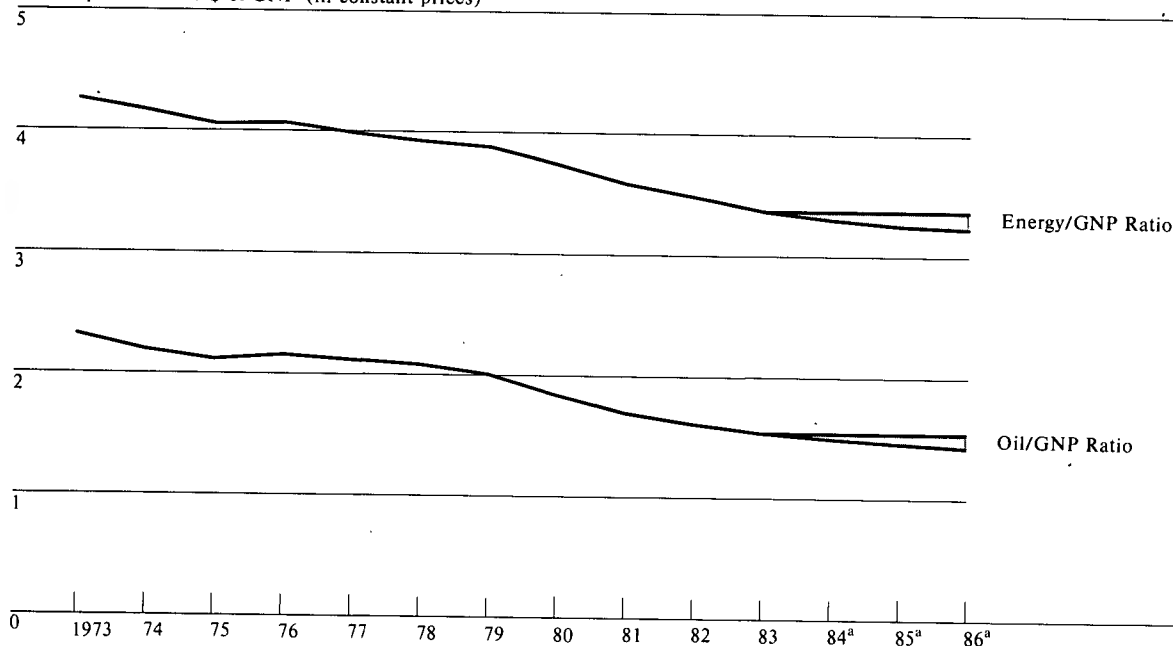
	Official Foreign Assets			Gross Debt			Net Assets ^a		
	1978	1981	1983	1978	1981	1983	1978	1981	1983
Saudi Arabia	57	144	130	4	6	6	53	138	124
Kuwait	30	63	67	3	5	6	27	58	61
United Arab Emirates	15	33	36	5	5	6	10	28	30
Iraq	10	21	3	2	3	5	8	18	-2
Iran	19	10	11	12	8	6	7	2	5
Nigeria	2	4	1	4	9	15	-2	-5	-15
Venezuela	9	14	12	16	30	36	-7	-16	-24
Libya	6	12	7	1	1	1	5	11	6
Indonesia	3	6	5	15	20	28	-12	-22	-23
Other	10	20	21	20	24	24	-10	-4	-3
Total	161	327	293	82	111	133	79	208	159

^a Assets minus debt.

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Figure 1
OECD Energy and Oil/GNP Ratio

Barrels per thousand \$ of GNP (in constant prices)

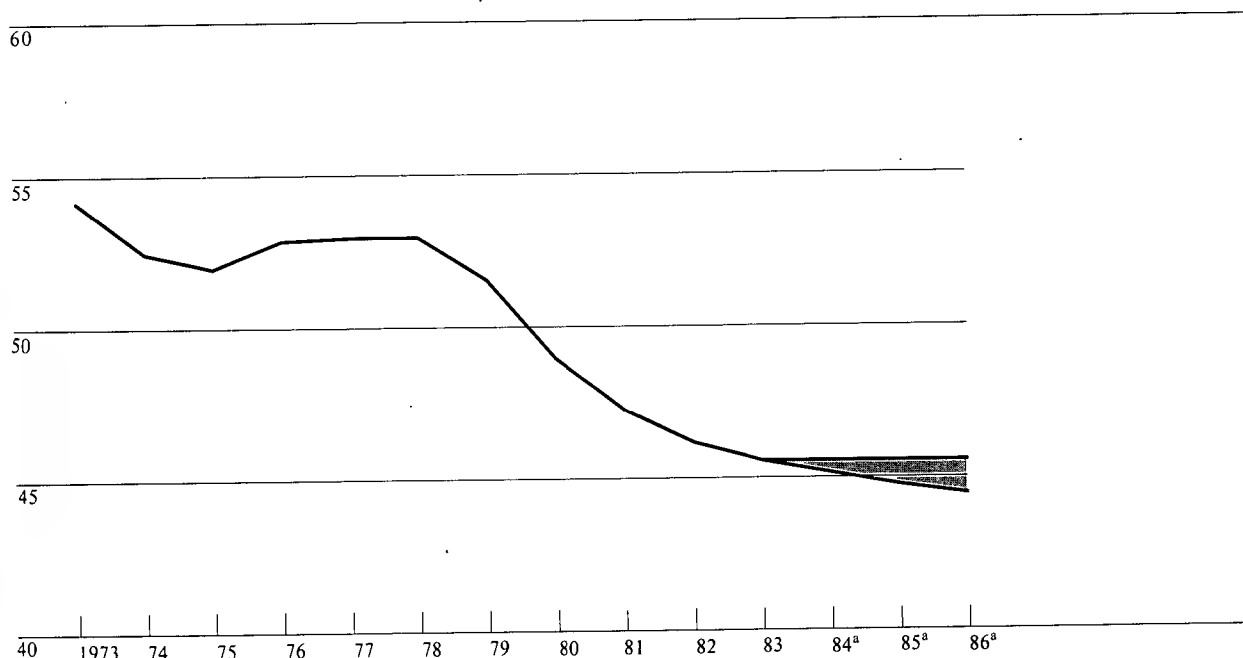
^a Projected.

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Figure 2
Percent Share of Oil in OECD Energy Consumption



^a Projected.

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non-OPEC producers, but net exports from Communist countries are more likely to decline slightly than to increase.

9. These basic projections yield a fairly broad consensus that the demand for OPEC oil will increase by 2 to 3 million b/d from 1983 to 1986. Projections by the International Energy Agency (IEA), and major governments, oil companies, and other private institutions are nearly all in this range. Table 4 presents illustrative projections of demand for OPEC oil which include a consensus projection of non-Communist oil demand. But plausible cases have been made for lower, or higher, projections of demand for OPEC oil.³

— On the high side, it is conceivable that several years of falling real oil prices and the impact of a

³ Moreover, changes in currency exchange rates are a major uncertainty in projection of oil demand. Nominal oil prices are set in US dollars and have not been changed to reflect changes in the dollar's purchasing power over other currencies. In recent years, the prices of oil, although falling in dollar terms, have increased or

strong economic recovery on the economic structure will raise the energy-to-GNP ratio, and push up demand for OPEC oil by as much as 4 million b/d.

— On the low side, if the Western economic recovery should be prematurely ended or greatly slowed, OECD demand growth would be small and LDCs, especially the large debtors, would be forced to further curtail their demand. The result might be little (that is, 1 million b/d) growth in the demand for OPEC oil by 1986.

remained stable in most other major currencies. A substantial drop in the value of the dollar would lower oil prices elsewhere, and consequently would strengthen oil demand.

Inventory decisions will be another important uncertain factor. Despite large-scale oil company destocking in the last two years, a continued weak market and high interest rates—which increase the cost of holding stocks—are encouraging the companies to keep stocks low. Commercial stocks in OECD countries currently amount to 2.7 billion barrels, with some 100 million barrels surplus to normal operating needs. Another 500 million barrels are held in government-owned stockpiles—mainly in the United States, Japan, and West Germany.

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Table 4

Million b/d

Non-Communist Oil Supply and Demand^{a b}

	1983	1984	1985	1986
Total consumption	44.0	44.8	45.4	46.0
Inventory change	-1.0	-0.3	0.2	0.1
Supply	43.0	44.5	45.6	46.1
Total non-OPEC	24.5	25.0	25.0	25.0
OECD	15.8	15.9	15.8	15.8
United States	10.2	10.2	10.1	10.0
Canada	1.6	1.6	1.5	1.5
United Kingdom	2.4	2.5	2.6	2.6
Norway	0.7	0.7	0.7	0.7
Other	0.9	0.9	0.9	1.0
Non-OPEC LDCs	7.2	7.6	7.8	7.9
Of which:				
Mexico	2.9	3.0	3.1	3.2
Net Communist exports	1.5	1.5	1.4	1.3
Implied demand on OPEC	18.5	19.5	20.7	21.1

^a Excluding refinery gain.^b Because of rounding, components may not add to the totals shown.

Pressures To Raise OPEC Oil Production 25X1

10. With the demand for OPEC oil likely to increase by only 2 to 3 million b/d over the next three years, several OPEC countries will have great difficulty making ends meet, and will try very hard to increase their oil exports and market shares. Indeed, Nigeria, having slashed its imports and nearly exhausted its foreign exchange reserves and borrowing potential, has since early 1984 been producing well over its OPEC quota. Iraqi production, which has been limited by the war, is likely to increase substantially over the next three years if the war ends. Even if it continues, construction of additional export pipelines now in the planning stage would add to capacity. During the next three years, we see the following potential increases in OPEC oil supplies over second-half 1983 levels, reflecting desired production levels or bounds to export capacity:

Nigeria	0.4-0.7 million b/d
Venezuela	0.2-0.5 million b/d
Libya	0.1-0.5 million b/d
Iran	0.5-0.8 million b/d
Iraq	1.0-2.0 million b/d
Other (except Saudis)	0-1.0 million b/d
Total	2.2-5.5 million b/d

11. These pressures to raise production will be strong throughout 1984 and even stronger in 1985-86, when new Iraqi export capacity may come on stream and patience with several years of economic austerity in several of OPEC countries wears thin. With demand for OPEC oil increasing only slowly, it will be difficult to reconcile the interests of OPEC members. Saudi Arabia will play the key role in holding OPEC together (see table 5).

Nigeria

12. The new Nigerian military regime has promised to improve living standards and rescue the nation from its worst economic recession since the civil war of 1967-70. It is counting on increased oil revenues and Western economic help—the International Monetary Fund (IMF), debt rescheduling, and new loans—to do so. Nigeria's oil output in February averaged about 1.6 million barrels per day, up 200,000 b/d from January. Oil company concern about an escalation of hostilities in the Gulf and a surge in US demand probably helped Lagos sell more oil this past winter. Nigeria is lobbying for an increase in its OPEC quota.

13. Nigeria's economic predicament is a direct result of the weak oil market and economic policies that encouraged imports and discouraged nonoil exports. Oil revenues in 1983 were less than half their peak level in 1980. To make ends meet, the previous government cut imports in 1983 to the lowest level in seven years, resulting in major shortages of essential consumer and industrial goods and record unemployment; urban unemployment is about 30 percent. At the same time, the government piled up unpaid bills amounting to \$7-8 billion. Despite these measures, Nigeria's foreign exchange reserves have dipped well below \$1 billion, compared with \$10 billion in 1980. Lacking any alternative major source of increased export earnings, the Nigerians almost certainly will try to push up oil production toward the available capacity level of over 2 million b/d.

14. Major General Buhari, the head of state, believes he must show progress on the economic front and in other areas to fend off a coup by lower ranking officers or a palace coup. Buhari's takeover reportedly preempted a similar action by middle-grade officers. These officers regard many senior officers in the new government as corrupt and believe Buhari is moving too slowly on the economic front and too leniently in dealing with officials of the previous government.

15. The Nigerians will consider various ways of marketing increased output. They may renew efforts to sell crude at discounted prices to the US Strategic

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Table 5

Million b/d

Non-Communist Oil Supplies ^a

	Available Capacity ^b	Second Half 1983 Production	Production Quota	Surplus Capacity
OPEC Persian Gulf	17.2	12.7	—	4.5
Saudi Arabia	8.0	5.7	^c	2.3
Iran	3.2	2.4	2.4	0.8
Iraq	1.3	1.0	1.2	0.3
Kuwait	1.2	1.0	1.05	0.2
United Arab Emirates	1.6	1.2	1.1	0.4
Qatar	0.6	0.4	0.3	0.2
Neutral Zone	0.6	0.4	^d	0.2
NGL	0.7	0.6	NA	0.1
OPEC Non-Persian Gulf	9.7	7.1	—	2.6
Indonesia	1.6	1.4	1.3	0.2
Libya	1.8	1.1	1.1	0.7
Nigeria	2.2	1.4	1.3	0.8
Venezuela	2.4	1.7	1.675	0.7
Algeria	0.9	0.7	0.725	0.2
Ecuador	0.2	0.2	0.2	—
Gabon	0.2	0.2	0.15	—
NGL	0.4	0.4	NA	—
OPEC Total	27	19.8	17.5	7.2
Non-OPEC	23.5	23.2	—	0.3
Mexico	3.2	3.0	—	0.2
Norway	0.7	0.7	—	—
United Kingdom	2.4	2.4	—	—
Canada	1.8	1.7	—	0.1
United States	10.2	10.2	—	—
Other ^e	5.2	5.2	—	—
Total	50.5	43.0	—	7.5

^a Estimated.^b Available capacity includes those facilities on line and capable of responding almost immediately to a decision to raise production. Production ceilings imposed by individual producers for policy reasons are also taken into account.^c Saudi Arabia has no formal quota, will act as swing producer to meet market requirements.^d Neutral Zone production is shared about equally between Saudi Arabia and Kuwait.^e Includes natural gas liquids.

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Petroleum Reserve and perhaps other Western nations' strategic reserves. Barter or foreign processing deals would be another option with the Nigerians attempting to disguise discounting. Lagos would also respond in kind to price cuts by others, particularly North Sea producers, whose crudes compete directly with Nigerian crudes. The Buhari government will probably try to achieve Nigeria's objectives through negotiations with other OPEC countries. As the former military government's top oil man, Buhari personally has considerable credibility in OPEC circles. A more radical Nigerian government would be more likely to make large unilateral increases in oil output.

16. In any event, should Nigeria have to live with anything close to the 1983 level of oil revenues, its political stability would be severely endangered. It is highly unlikely that any Nigerian government would have the political clout and will to take the painful measures necessary to diversify exports and rebuild a more balanced and healthy economy. Barring such unlikely fundamental reforms, stagnant oil revenues would almost certainly continue to bring economic stagnation, squabbling over a fairly fixed economic pie will breed growing political unrest, and the vast corruption which developed during the oil boom is unlikely to be much reduced. Captains, and later perhaps sergeants, may replace generals as heads of military governments, perhaps leading to the creation of radical anti-Western governments.

Venezuela

17. Venezuela's economic problems are not as acute as those of Nigeria, in part because Caracas has substantial foreign exchange reserves, but its dependence on oil export earnings is even greater. With oil revenues down 28 percent between 1981 and 1983, Caracas cut imports by a third from 1981 to 1983, and by more than half from 1982 to the second half of 1983, and imposed tight exchange controls. Venezuela's most urgent problem is servicing and refinancing a \$36 billion debt, most of which has been contracted by the government. Although in 1983 Venezuela produced oil at about its 1.7-million-b/d OPEC quota, it exported at an unsustainable rate by drawing down oil inventories.

18. Caracas probably can manage with its OPEC quota for perhaps a year. Venezuela, however, opposes any significant increase in the Nigerian quota and would push up oil production toward 2 million b/d unless it also were given concessions. In the longer term, however, political pressure to exceed the quota is bound to increase. Although Venezuela has a high

standard of living and strong democratic traditions, it too has no potentially significant source of income other than oil and a large part of its population depends on government spending from oil revenues for its sustenance. Stagnant oil revenues would mean several more years of declines in per capita real income. In this situation, Venezuelan democratic institutions would be subjected to severe strains, and the outcome would be uncertain.

Libya

19. The largely discretionary nature of Libya's hard currency expenditures and Qadhafi's volatility make the Libyan oil card potentially a wild one, with a capability for stability or disruption. Libya is not experiencing economic and political pressures as severe as those in Nigeria and Venezuela, despite producing oil far below capacity. Libya's population is small and its needs can be met with only a fraction of current oil revenues, which gives the government a wide range of choices regarding both oil production and spending. With current oil revenues, however, Libya would be hard put both to pay for massive Soviet arms imports and to finance a large domestic economic development program, including such multibillion-dollar projects as the Great Manmade River Project.

20. In the past two years, Libya has made major adjustments in support of a stable OPEC price. Imports, including food, have been trimmed by nearly 50 percent since the 1981 peak. Even so, foreign exchange reserves have fallen from \$12 billion in 1981 to \$6 billion in 1983.

21. Qadhafi's willingness to observe the OPEC agreement until now reflects:

- Qadhafi's desire to end his isolation in the Arab world. Ties with Saudi Arabia have improved, and Qadhafi received Saudi help in improving relations with Morocco.
- OPEC willingness to meet Qadhafi's quota request. The original OPEC draft agreement called for a quota of 850,000 b/d but the quota was subsequently raised to the current level of 1.1 million b/d.
- Libya's incumbency as president of OPEC from July 1983 to July 1984.

Over the next few years the Libyans almost certainly will try to raise production toward their capacity of 1.8 million b/d. However, unlike Venezuela and Nigeria, the Libyan Government is not under strong domestic political pressure to do so.

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Iraq

22. The loss of oil revenues as a result of the severing of two of three of Iraq's prewar export routes—seaborne shipments from the Persian Gulf and pipeline deliveries to the Mediterranean Sea via Syria—has forced Baghdad to slash imports nearly in half since 1981 and almost exhaust its foreign exchange reserves despite upwards of \$23 billion in aid from the rich Gulf oil states. Some of the Gulf aid has been in the form of oil deliveries to Iraqi customers on Iraqi account.

23. Iraq's oil production during the next few years will depend on the course of the war with Iran, the construction and expansion of export pipeline capacity, and what the market will bear. Even if the war continues, Iraqi oil export capacity could increase from the current 0.9 million b/d to 2.5 million b/d during the next two years. In addition to the nearly completed 0.3-million-b/d expansion of the pipeline through Turkey, Iraq is negotiating contracts to build a link with a capacity of 0.5 million b/d to the trans-Saudi pipeline, which could be constructed in about 18 months. And negotiations for constructing about a million-b/d line through Jordan are in progress. Even in the likely event that Saudi and Kuwaiti financial aid were to cease once these pipelines came on stream, Iraq would be able by 1986 to match the peak year—1980—oil earnings of around \$25 billion, although it might not be able to produce to capacity because of marketing constraints.

24. When the war ends, Iraq could increase its Gulf oil export capacity by some 1 million b/d within six to 10 months. This could be accomplished by the installation of single-point mooring buoys near the offshore facilities Iran destroyed early in the war. Within a year, Iraq's Persian Gulf export capacity could reach 2 million b/d. Iraq's Gulf export capacity would be only 1.2 million b/d less than the prewar capacity. The pipeline through Syria with a capacity of 1.2 million b/d might also be reopened.

25. When the war ends, Iraq's oil exports are likely to be limited more by demand and OPEC agreements than by productive capacity. Saudi Arabia will certainly pressure Iraq to restrain its oil production to help support the price of oil. This restraint could become a form of repayment for the large wartime Saudi aid. Even if the war does not end and the new export pipelines are all built, Iraq may not use them to full capacity.

Iran

26. Iran's oil exports are constrained mainly by the weak market rather than by the war. The Iraqis have

inflicted only negligible damage to production and export facilities in Iran so far. Iraqi attacks and threats have raised shipping and insurance costs, but the Iranians have absorbed these costs through price discounts.

27. Iranian oil production has averaged 2.4 million b/d—Iran's OPEC quota—over the past 12 months. This rate of production, which permits exports of about 1.9 million b/d, yields enough revenue to support the population at an austere standard of living and to finance the war.

28. Over the next few years, Iran will almost certainly try to increase its oil production and exports to help rebuild and expand the economy. There is currently about 1 million b/d of unused productive capacity. Moreover, Iran could increase capacity over the next few years if it began reorganizing its managerial structure, attempting to attract senior personnel back to Iran, and negotiating for foreign equipment.

29. Iran has been a "price hawk," although not on a consistent basis. Tehran wants to conserve its oil resources for the long term, partly in reaction to overproduction under the Shah, and wants to keep its economy and level of living lean. Iran argued vehemently in OPEC for price increases and against price cuts, and would probably raise prices if it had the opportunity. Tehran has often been critical of Saudi leadership in OPEC.

Other Producers

30. The other OPEC producers will generally continue to defer to Saudi leadership as long as price cheating does not get out of hand. Outside OPEC the United Kingdom, Norway, the USSR, and Egypt are likely to adjust their crude price periodically in line with spot market prices.

31. Since late 1981, Mexico has changed its oil policy from rapid to slow expansion of oil production. Mexico is cooperating with OPEC by holding oil production at about 3 million b/d, some 0.2 million b/d below sustainable capacity. Moreover, sharp cuts in the Mexican oil industry's investment budget have substantially reduced the likely expansion of capacity during the next few years.

32. The causes of Mexican restraint in oil production at a time when severe financial difficulties forced cuts of almost 70 percent in imports and a sharp decline in economic activity are complex. They probably include the following: a reassessment of oil reserves; the extraordinary corruption in the government oil monopoly (PEMEX), even by Mexican standards; the bureaucratic tendency to force all agencies to

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share in budget cuts; the Mexican Government's realization that oil producer cooperation was necessary to support the price of oil; and perhaps the desire of the de la Madrid administration to slowly diversify the economy away from oil to lay a healthier foundation for economic growth. Although some of these considerations will probably diminish in importance over time, it is highly unlikely that the Mexicans will soon return to a policy of headlong oil expansion.

Saudi Arabia—the Balancing Factor

33. Saudi oil policy reflects a mix of economic, security, and foreign policy objectives and concerns. The basic concerns are the position of the royal family and the stability of the political system. Against this background, Riyadh understands that Saudi Arabia's economic interests are probably best served in the long term by an oil price low enough to ensure a continued large market for its vast oil reserves. Riyadh at times has taken tough positions to protect its interests; it has also compromised to avoid confrontations potentially disruptive to its relations with other states.

34. Saudi public and private statements indicate a desire to maintain stable nominal oil prices in the next few years. Although the Saudis probably believe that oil is still somewhat overpriced, they would probably prefer to let the real oil price be eroded by inflation rather than to undertake the difficult task of negotiating a lower nominal price. Moreover, having seen a substantial retrenchment in Western plans for development of alternative energies and in drilling for new oil and gas reserves, the Saudis do not view price cuts as necessary to protect their long-term market, a key economic concern.

35. In our judgment, the Saudis will not make a major issue of small-scale production "adjustments" by Nigeria or other OPEC members. Saudi Oil Minister Yamani has expressed support for Nigeria's desire to increase its quota, and the Saudis have turned the other cheek to small violations by others in the past. Riyadh might offer Lagos financial aid in an effort to discourage large-scale cheating.

36. We believe the Saudis would be willing to play the role of swing producer in OPEC as long as others show reasonable restraint. This could mean further reduction in Saudi production for a limited period. Domestic requirements for associated gas are a consideration, but not a critical constraint. Although the Saudis claim they must now produce 4-5 million b/d of oil to meet their associated gas needs, they could manage with as little as 3 million b/d with adjustments

in the oil mix and maximum switching in power stations from gas to liquid fuels.

37. In 1983, Saudi Arabia's foreign assets declined by about \$20 billion, or about one-sixth. An additional cut of 1 million b/d in oil exports, with prices and expenditures remaining the same, would reduce export revenues by another \$10 billion. Some fairly easy reductions could be made in imports, remittances, or other expenditures: up to now, although some new investment projects have been curtailed, overall imports have remained near their peak level. We believe that the Saudis would tolerate an oil production cut to a level of around 4 million b/d for a year or two, if this seemed essential to maintaining a stable oil price and longer term market prospects seemed favorable.

38. In recent years, some radical OPEC members—especially Iran and Libya—have tried to intimidate Saudi leaders into making concessions on oil issues by threatening to promote subversion in Saudi Arabia or terrorism against Saudi interests abroad. There is no indication that these efforts have had any major impact on Saudi oil policy or that Riyadh contemplates any oil policy changes. Nevertheless, we cannot rule out the possibility that, should Iranian power become dominant in the Persian Gulf, and Saudi Arabia were also subjected to protracted externally directed subversion, the Saudi Government would no longer have the self-confidence to play a strong leadership role in OPEC. This might mean, for example, not increasing their oil production to prevent other OPEC countries from raising oil prices.

Prospects for the Oil Market

39. The balance of oil market forces in the next three years or so appears to be downward.⁴ There is more than enough excess capacity in OPEC to cover any conceivable increase in demand. Even if demand for OPEC oil should increase relatively quickly (that is, by 3 or 4 million b/d), there would be ample new supplies from OPEC countries anxious for the opportunity to increase their earnings, and consequently no

⁴ The OPEC countries' growing role in product markets, initially planned in order to capture the profits in this sector, may cause additional problems for the organization in controlling crude prices. Oil product prices are not included in the cartel's official price structure and OPEC members have little recourse if producers choose to discount product prices, even though such discounts tend to erode crude prices. Furthermore, product sales are more difficult to monitor than crude sales. Current OPEC product export capacity amounts to only about 1.5 million b/d, but projects under construction, principally in Saudi Arabia and Kuwait, will add an additional 0.9 million b/d in capacity by 1986. Purchase of foreign downstream capacity, primarily by Kuwait, will add to OPEC's product sales potential.

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upward pressure on prices would be likely to develop. Only in an extreme case of a large increase in demand for OPEC oil coupled with severely limited Iraqi capacity would it be necessary for Saudi Arabia to raise its output to balance the market, and even then Saudi production would remain below a level likely to trigger interest in a price increase. With a relatively slow increase in the demand for OPEC oil (that is, 1-2 million b/d), there would be severe pressures on OPEC. Even if other OPEC countries were restrained in increasing production, Saudi Arabia would have to cut production to keep oil prices from falling. Agreement on production quotas within OPEC would be difficult and the Saudi role crucial.

40. Although it is possible that OPEC cooperation will break down, resulting in a precipitate price fall, it is more likely that there will be continued agreement to support a stable price. This means that Saudi Arabia and the other southern Gulf countries will not have to carry the entire burden of supporting the price: that other OPEC countries will continue to produce below capacity. Although there is great economic and political diversity among OPEC countries, the common interest in a stable price which brings in large government revenues is strong. Moreover, patterns of cooperation have been developing, especially in the past year or so. Although we believe maintenance of the current \$29 price to be likely, a decline to \$25 or so is possible if the Saudis should reassess longer term market prospects.

41. In the unlikely event of a breakdown of OPEC cooperation, headlong competition for oil market shares would cause a precipitate drop in the price of oil—probably to \$15 or even lower. It is highly unlikely that such a situation would last more than a few months before the common interests of the OPEC producers would reassert themselves, leading to a new price agreement, presumably on Saudi terms and in the \$25 to \$29 range.

Potential for Supply Disruption

Iran-Iraq War

42. The development most likely to lead to a tightening of the market is an expansion of the Iran-Iraq war. The combination of Iran's dedication to pursuing the war and Iraq's desire for an end to it have prompted Baghdad to initiate attacks against Iran's oil lifeline. Iran, in turn, has threatened to retaliate for such an Iraqi move by closing the Gulf to oil exports; some 8 million b/d of oil exports now transit the Strait of Hormuz. We also believe Iran

might strike out at the oil facilities of the other Gulf producers that are providing economic and logistic support to Iraq in the event of an escalation by Baghdad (see table 6).

43. The Iraqis reportedly have developed plans for direct air attacks on Khark island, Iran's major oil export terminal, and are threatening to continue to escalate attacks on oil shipping from Iran. The French delivery to Iraq of Super Etendard and Mirage F-1 aircraft, configured to carry Exocet antiship missiles, has improved the capability of the Iraqi Air Force to strike at tankers. Even though the Iraqi economic decline may have bottomed out—the precipitate fall in imports appears to have ended in the second half of 1983, and the economy could improve considerably in 1986 if Iraq can open pipeline outlets to the Red Sea—major Iranian military gains on the ground could trigger all-out attacks on Iranian oil exports.

44. Iraqi strongman, Saddam Hussein, probably has not yet moved in a major way against Iranian oil because he has doubts about his Air Force's capability to inflict enough damage to change radically the military outlook, a fear of heavy Iraqi losses, and a concern over the international reaction. The Iraqis have adhered to a conservative military strategy since their attack into Iran at the beginning of the war. Despite a massive advantage in equipment, the principal Iraqi goal has been to find a way out of the war and hold down casualties. Indeed, we believe the Iraqis see escalation as a way not only to impair Iran's warmaking capacity, but also to encourage Tehran to begin negotiations to end the war, and, failing that, to force the West to intervene. In any event, we expect Iraq to continue its attacks against shipping to Iran and against Iranian cities and naval units. We also expect continued public and private threats by the Iraqis to escalate.

45. We do not believe Iran would immediately attempt to close the Strait of Hormuz to oil exports or strike Saudi oil targets in response to an Iraqi attack on its oil lifeline. Instead, it probably would take other steps less likely to provoke Western military reaction. Likely shortrun Iranian responses would include attacks against military and oil targets in Iraq, including the Iraq-Turkey pipeline, increased subversion and terrorism in the southern Gulf states, small-scale attacks on oil facilities, especially in Kuwait, and harassment of shipping in the Gulf or the Strait of Hormuz.

46. A prolonged interruption of Iranian oil exports by Iraq almost certainly would trigger a major escalation by Iran. Iran would probably take military and

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Table 6
Major Developed Countries: Estimated Dependence
on Persian Gulf Oil Imports,
January-September 1983

Thousand b/d

	Iran	Iraq	Kuwait	Qatar	Saudi Arabia	United Arab Emirates	Total Persian Gulf Oil	Total Developed Country Supply ^a	Persian Gulf Oil as a Share of Supply (percent)
Total	1,282	407	363	208	2,716	948	5,924	36,627	16
United States	59	10	9	NEGL	252	26	356	15,061	2
Japan	352	12	105	144	1,264	604	2,481	4,160	60
Canada	34	0	5	0	8	0	47	1,893	2
Western Europe	837	385	244	64	1,192	318	3,040	15,513	20
West Germany	47	26	27	6	145	30	281	2,290	12
France	88	25	19	20	294	128	574	1,860	31
Italy	229	111	90	10	227	66	733	1,880	39
United Kingdom	11	17	13	0	114	22	177	3,060	6
Austria	1	0	0	0	27	0	28	195	14
Belgium/Luxembourg	8	37	1	3	38	0	87	723	12
Denmark	3	0	18	0	4	0	25	266	9
Finland	7	0	0	0	11	0	18	243	7
Greece	8	24	0	0	97	0	129	339	38
Netherlands	118	3	67	3	47	9	247	1,591	16
Norway	0	0	0	0	5	0	5	684	1
Portugal	25	19	0	0	49	7	100	208	48
Spain	163	45	0	22	99	54	383	1,096	35
Sweden	16	0	0	0	1	0	17	476	4
Switzerland	1	0	0	0	10	2	13	255	5
Turkey	112	78	9	0	24	0	223	347	64

^a Production plus imports.

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paramilitary actions against the southern Gulf states, including Saudi Arabia, in the form of air attacks, naval commando raids, terrorist actions, and sabotage on key oil facilities and other economic targets, such as electric power and desalinization plants. Most oil facilities are vulnerable to such attacks. Air defenses could not repel initial surprise air attacks; some offshore oil facilities are lightly defended and could be taken by surprise, as were the Iraqi offshore terminals; and the local security services would be hard pressed to anticipate internal attacks by domestic Shias, some members of whom have been trained by Iran and who constitute about one-third of the Saudi oil industry labor force.

47. But although the facilities are vulnerable, damage may be limited, and the impact on oil production even more so. The Iranian Air Force has only 70 to 80

operational aircraft and is poorly trained. The Iranians would need a great deal of luck to do major damage in a first strike, and subsequent airstrikes would probably be challenged. Some of the most important Saudi oil facilities can be defended against commando or terrorist attacks while others are hard to reach. Most important, there is enough excess capacity and flexibility in the Saudi oil system that production could be maintained under all but extreme circumstances.

48. Major damage to Saudi Arabia's most critical oil facilities—the Ras Tanura and Juaymah oil terminals and the Abqaiq processing facilities—could force a shutdown of Saudi production for up to two months while damage control and emergency operation planning efforts were under way. If key technical personnel are willing to work in this wartime environment, production and export levels of about 2 million b/d

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could be achieved shortly after this shutdown in all but the worst conceivable Iranian attacks. With US assistance, current production levels could probably be achieved using emergency restoration efforts an additional three to five months after the facilities were secured from further Iranian attacks.

49. It would be easier for Iran to make the Gulf unsafe for tanker traffic, but such action could be expected to trigger immediate US and allied military intervention. Tehran cannot reasonably expect to keep the Strait closed in the face of such intervention, but may believe that conventional and unconventional attacks against tankers in the Strait and elsewhere in the Gulf would reduce Gulf oil trade to a trickle. Tankers are highly vulnerable not only to mines but also to attacks by military planes, small Kamikaze aircraft, small armed boats, and sabotage. It might take a large US and allied military presence to counter this threat. Iran probably could survive a prolonged cutoff of its own oil exports—its foreign exchange reserves would cover a year's imports. A complete blockade of its trade through the Gulf, however, would cause a serious drop in grain supplies. Iran probably could meet its military and minimum civilian requirements for several months using land and air routes for its imports. This would require Soviet cooperation, which would be problematical.

50. A worrisome aspect of a potential escalation of the war is the psychological impact on the employees of the oil industry in the southern Gulf. Iranian terrorism could be directed not only against key oil facilities but also against Aramco employees and their homes and families. Insecurity both in the workplace and at home could trigger a major exodus of foreign employees, including critical technicians, unless very effective countermeasures were taken. This threat may be more difficult to counter than the threat to the facilities themselves.

Other Supply Disruptions

51. The expansion of the Iran-Iraq war is the most obvious, but not the only, potential source of supply disruption. We cannot predict where or when other disruptions would occur, but note the possibility that political problems could get out of hand in such important producing nations as Nigeria, Libya, Mexico, or even Saudi Arabia.

52. Another Arab-Israeli war, accompanied by an Arab oil embargo against the Western nations, is a remote possibility, but cannot be dismissed. An embargo is likely to be—and, more important, perceived in

Since 1950 oil supplies from major exporting countries have been disrupted on 14 occasions. Most of these occasions were of short duration—less than five months—and produced only small losses in production—less than 1 million b/d relative to world oil trade. With the exception of the Nigerian civil war of 1967-70, all of the disruptions occurred in the Middle East.

The most serious disruptions were in the Persian Gulf area. The longest was 44 months and resulted from the nationalization of the Iranian oilfields. The most serious in terms of output was the loss of 3.7 million b/d of Iranian oil as a result of the Iranian revolution in 1978-79.

the market to be—of short duration. To be effective even for a short period, the embargo would have to be accompanied by a substantial cutback in production. In the absence of such a cutback, the flexibility of the international oil market would enable consumers to switch suppliers with little difficulty. The end result would be either (1) Arab oil would go to non-Western consumers while the non-Arab oil it displaced (and probably increased non-Arab output) would go to the West, or (2) the Arab oil would move through several middlemen to the West despite the embargo.

Reaction to Disruption

53. The near-term market impact of any major supply disruption would depend most importantly on the market's expectation of the duration and magnitude of the disruption. Although uncertainties and rumors in the early stages of a disruption would exacerbate price pressures, the most likely disruptions would probably generate only a small price spike lasting from a few days to a few weeks. If, for example, in response to an Iranian closure of the Strait, Western nations moved quickly to reopen the waterway, the market probably would be reassured, and the incentive to hold stocks would be reduced. The current combination of surplus productive capacity and inventories provides consumers more protection than they had at the time of the last major price rise—at the beginning of the Iranian revolution.

54. Changes in the structure of the oil market since 1979 also will tend to dampen speculative stockbuilding. Lags between spot market and official price increases will be shorter because most oil producers need money badly. The spot market is much broader. More OPEC oil is being traded under short-term contract and on-the-spot market; some market analysts

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How the Current Situation Differs From 1978/79

In 1979 the Iranian revolution set in motion a sequence of events which resulted in a 170-percent increase in oil prices. In the event of an oil supply interruption in the Persian Gulf, we do not expect oil price increases of this magnitude and, once the disruption ends, we would expect prices to return to their predisruption level. The present situation differs from that in 1978 in the following ways:

- There is a great deal more excess oil production capacity in OPEC countries than in 1978, the largest amount being in Saudi Arabia.
- There is every reason to believe that the Saudis do not want oil prices to rise and would use their capacity to hold prices down; in 1979 the Saudis at first did not resist a price increase and later lacked the capacity to block further increases.
- Government oil stocks are larger than in 1978-79.
- An interruption of Persian Gulf oil supplies would be considered temporary and probably short lived; the reduction in Iranian oil production during the revolution was considered permanent.
- Oil consumption growth is now widely expected to be slow for several years; in 1979, large future increases were expected.
- Western dependence on Persian Gulf oil has declined.

estimate that spot transactions account for 20 to 25 percent of total non-Communist oil trade, compared to 5 to 10 percent in the 1970s. The increased availability of cracking facilities has promoted easier switching among the various crudes and more flexible stock management.

55. We believe the Saudis, for economic as well as political reasons, are currently committed to preventing a large and lasting price rise and would utilize their excess capacity to the extent possible in the event of a disruption. The Saudis admit that the price surge in 1979-80 is a major factor in OPEC's current problems and understand that large oil price increases will erode demand for its oil over time, their key economic consideration. In discussions of contingency planning with other Gulf nations—in the Gulf Cooperation Council—the Saudis have pressed for acceptance of a major US role if Iran tries to block the Strait, but they have not been willing to make "precrisis" arrangements to facilitate possible US actions.

56. The Saudis have also recently built up stocks outside the Persian Gulf that they probably would release in the event of a Gulf disruption. We estimate out-of-country inventories—in both tankers and on-shore stocks as of 1 April—at 50-60 million barrels of crude oil, more than a week's net oil flow from the Gulf.

57. The only circumstances under which the oil price rise could be large and last several months appear to be the following:

- Iranian success in making the Gulf unsafe for oil shipping for an extended period.
- Destruction of sufficient Saudi oil production and export capacity to prevent Saudi Arabia from controlling the price of oil through increased production.

Other Supply Factors

58. Most countries outside the Gulf would react to a surge in spot prices, as a result of a disruption, by raising export prices. The increases could be only small ones if Saudi Arabia were able to support the current price, but they could be massive (50 percent or more) if Saudi Arabia could not provide such support. Libya, Nigeria, and Venezuela might also raise production as well, but first they would raise prices, so that demand might be met without ever reaching capacity levels. They would be most likely to increase production to sustain oil revenues when prices had started down, thereby adding to the downward pressure.

59. So far, other than the United States, industrial nation governments holding strategic oil reserves have not announced specific plans to use their stocks in an emergency. West German and Japanese officials consider their government stockpile a "final reserve." Recent US statements that it would use its strategic stocks in the early stages of a disruption probably would ease market uncertainties.

60. A major supply disruption—the type of problem the International Energy Agency⁵ was organized to solve—could trigger the IEA allocation system. Effective operation of the system, however, would depend on the political will of the members. For example, members could differ substantially over whether or not each country's measures to reduce oil

⁵ The IEA, formed by OECD members other than France in 1974, has devised an emergency oil allocation program. The system can be "triggered" when any member country suffers a 7-percent decline in oil imports. The European Community runs a parallel program which includes France.

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demand constituted a sufficient response. In any event, the IEA provides an important forum for information sharing and policy coordination.

The relative market stability during the disruption caused by the outbreak of the Iran-Iraq war in 1980 was due in part to the existence of about 400 million barrels of excess stocks that stockholders were willing to deplete. In addition, consumption was falling and the IEA was urging members to refrain from spot market purchases. The OPEC average official sales price rose only from \$31.74 to \$34.64 per barrel during the period despite a loss of 4 million b/d in supplies from Iran and Iraq.

Oil Price Changes and Economic Impact

Price Declines

61. If the real price of oil moves slowly downward over the next several years, or there is a moderate decline in nominal oil prices, the impact on the world economy should be favorable. In the industrial countries, lower oil prices would provide opportunities for accelerating economic growth, further slowing inflation without lowering economic growth. These benefits would be partly offset in countries with substantial oil production, like the United States and the United Kingdom, by decreased incomes in the oil sector. Oil-importing LDCs would tend to benefit both directly, through lower import prices, and indirectly, as a result of higher demand for their exports and/or lower interest rates. Oil-exporting countries would, of course, suffer direct losses, but at least some of them would obtain offsetting gains from higher nonoil export earnings and/or lower interest rates to service debt. The USSR would end up as a net loser and most of the East European countries as net winners. A \$5 per barrel real price drop would probably not cross any important thresholds affecting energy conservation or interfuel substitution, nor would it make any significant amount of oil production unprofitable.

62. For illustrative purposes, table 7 shows the direct impact of a \$5 per barrel decline in oil prices on the values of oil imports and exports of the major nations, assuming no change in the volume of trade. Considering also the indirect effects on incomes and inflation, a \$5 per barrel oil price decline would raise OECD GNP by at least 0.5 percent after two years.

63. A sharp drop in oil prices, for example to \$15 or \$20 per barrel, would create economic problems, along with substantial benefits, for oil consumers.

While it lasted, it would contribute to economic growth and lower inflation in the industrial countries. Oil-importing debtor countries would gain a windfall, which could be used to reduce their debt obligation. At the same time, oil investments, and perhaps investments in some other forms of energy, probably would be put on hold until the market situation became clearer, and oil-exporting countries would face severe financial difficulties. More generally, an unstable oil price would create substantial uncertainty in financial markets.

Price Increases

64. A small, brief oil price increase should have little impact either on basic or cyclical economic trends or on government economic policies. The attendant uncertainty and publicity, however, would no doubt influence financial and commodity markets and would complicate the already difficult problem of negotiating new loan packages and programs for debt-ridden, oil-importing LDCs, such as Brazil.

65. In the event of a large oil price increase—for example, a 50-percent increase for six months—growth of OECD GNP would be reduced.

66. Oil-importing LDCs, such as Brazil, Chile, and the Philippines would be seriously hit by sharply higher oil prices. They have already made severe internal adjustments to manage their debt problems and would be hard put to make further import cuts. A substantial oil price increase lasting many months would probably force some such countries to discontinue interest payments on debt.

The Soviet Role

67. The Soviet role in the world oil market is unlikely to change substantially during the next few years. Soviet hard currency oil exports probably will level off or decline slightly, in contrast to the substantial increases of the past two years. Even if recent difficulties are resolved and a slow growth of production is resumed, domestic oil demand is likely to increase as much as or more than oil output. Meeting domestic and East European oil requirements while maintaining a high level of oil exports for hard currency is an expensive proposition for Moscow. Investment in the Soviet oil industry during 1981-85 will be double the 1976-80 level.

68. The USSR, a major exporter of both oil and gas to the West, would be an important financial beneficiary of a large supply disruption and price hike. Its hard currency revenues would rise substantially; every \$5 per barrel increase would mean about \$2.5 million

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Table 7

Direct Trade Impact of \$5 per Barrel Oil Price Decline ^a

	Decrease in Export Revenues (Billion US \$)	Total Exports, 1983 (Billion US \$)	Column 1 as a Percent of Column 2
Major Exporting Nations			
OPEC			
Saudi Arabia	7.6	45.9	16.6
Nigeria	1.9	11.3	16.8
Venezuela	2.3	14.0	16.4
Kuwait	1.6	11.7	13.7
Libya	1.9	11.2	17.0
Other			
United Kingdom	2.9	92.0	3.1
USSR	2.5	34.5 ^b	7.2
	Decrease in Net Import Costs	Total Net Imports, 1983	Column 1 as a Percent of Column 2
Major Importing Nations			
Industrial			
United States	7.2	258	2.8
West Germany	3.6	153	2.3
Japan	7.6	114	6.7
France	2.9	101	2.9
Italy	2.9	81	3.6
Other			
Brazil	1.8	21.9	8.2
India	1.4	14.8	9.5
Pakistan	0.2	5.6	3.6
South Korea	1.5	24.8	6.0

^a Assuming no change in volume of exports from 1983.^b Hard currency, excluding arms sales.

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annually in additional income, an amount equal to 7 percent of current hard currency earnings.

69. The Soviets could also benefit indirectly from disruptions in Western, Third World, and rich Gulf state economies, including strains among Western countries and between the West and the Third World that would result from reduced oil supplies. Cuba, Vietnam, and Eastern Europe, who depend on Soviet oil, would be little affected.

70. The USSR would be a factor in any major escalation of the Iran-Iraq war which threatened Gulf oil supplies. The proximity of Soviet military power and Moscow's expressed high interest in the Gulf area, and in the northern Gulf in particular, are important considerations affecting Allied responses to Iranian

moves. There are no indications, however, that Moscow is seeking a crisis over Persian Gulf oil.

71. Declining oil prices would mean reduced Soviet hard currency earnings which, however, could be partly offset by cutting back deliveries to Eastern Europe to free additional oil supplies for hard currency sales. A further cut in Soviet oil deliveries to the nearly stagnant economies of Eastern Europe would intensify the need for austerity measures and aggravate the danger of popular unrest there. These countries might increase attempts—in a soft market—to barter goods for oil to replace Soviet cutbacks. The link between oil and gas prices would work to Soviet disadvantage in the near term by depressing gas prices, but would further discourage development of alternative gas supplies in Western Europe and improve the Soviet long run-market prospects.

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